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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 575

AMERICAN SURETY COMPANY OF NEW YORK, a corporation, *Petitioner*,

v.

SUNDBERG & SONS, a partnership, et al., and the UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WASHINGTON

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November 27, 1961

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INDEX

	Page
Opinion below	1
Jurisdiction	2
Questions presented	2
Statutes Involved	3
Statement	3
Reasons For Granting The Writ	6
Conclusion	12
Appendices	1a

CITATIONS

CASES:

American Surety Co. v. Sampsell, 327 U.S. 269	11
Aquilino v. United States, 363 U.S. 509	9
Carey v. Herrick, 146 Wash. 283, 263 P. 190	7
Conard v. Atlantic Insurance Co., 26 U.S. (1 Pet.) 386	7
Eltopia Finance Co. v. Colley, 126 Wash. 554, 219 P. 24	7
Henningsen v. U. S. F. & G. Co., 208 U.S. 404	11
Home Savings & Loan Assoc. v. Burton, 20 Wash. 688, 56 P. 940	7
Johnson Service Co. v. Roush, 355 P. 2d 815	11
Levinson v. Linderman, 51 Wash. (2d) 855, 322 P. 2d 863	11
Little Lake Lumber Co. v. Baugh (CCA 9) Case No. 17230, decided October 18, 1961	12
Morgan v. Commissioner, 309 U.S. 78	9
Prairie State Bank v. United States, 164 U.S. 227	11
United States v. Aeri, 348 U.S. 211	6
United States v. Ball Construction Co., 355 U.S. 587	6
United States v. Bess, 357 U.S. 51	9
United States v. Bond, 279 F. 2d 837	6
United States v. Christensen, 269 F. 2d 624	6
United States v. City of New Britain, 347 U.S. 81	6

Page

United States v. Colotta, 350 U.S. 808 6
United States v. Durham Lumber Co., 363 U.S. 522 .. 9
United States v. Scovil, 348 U.S. 218 6
United States v. Security Trust & Savings Bank, 340 U.S. 47 6
United States v. Vorreiter, 355 U.S. 15 6
United States v. White Bear Brewing Co., 350 U.S. 1010 6
United States v. Worley, 213 F. 2d 509 12

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AMERICAN SURETY COMPANY OF NEW YORK,
a corporation, *Petitioner,*

v.

SUNDBERG & SONS, a partnership, et al., and the
UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WASHINGTON

Petitioner seeks a writ of certiorari to review the judgment of the Supreme Court of the State of Washington.

OPINION BELOW

The opinion of the Supreme Court of Washington (Appendix A, *infra,* pp. 1a-15a) is reported at 57 Wash. (2d) 335; 363 P (2) 99.

JURISDICTION

Petition for rehearing was denied on August 29, 1961. The judgment of the Supreme Court of Washington was entered on August 31, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1257 (3).

QUESTIONS PRESENTED

1. Whether a conventional mortgage to secure future advances is subject to the choateness rule heretofore applied under Sections 6321-22, Internal Revenue Code, 1954, or whether it is an exception under Section 6323(a), and thus not subject to the choateness rule.

2. Whether it is necessary to determine, according to State law, the beneficial ownership of property, as between a taxpayer-mortgagor and a mortgagee, before the choateness rule may be invoked.

3. Whether a State court may determine according to State law that a mortgage to secure future advances is effective from its date of execution, and then hold that federal law requires the application of the federal rule of choateness for purposes of federal taxation.

4. Whether income received by a mortgagee from a third party, by reason of a previous express assignment from the mortgagor, as well as by operation of law, may be treated by the Court as payment of mortgage-secured debts in such a way as to dissolve the priority of the mortgage, advance the position of the tax lien, and thus abrogate the doctrine of "first in time is first in right."

5. Whether a federal tax lien filed only in the name of a partnership reaches property belonging to individual partners.

STATUTES INVOLVED

Sections 6321, 6322, 6323 (a) and 6303, of the Internal Revenue Code of 1954, are set forth in Appendix B, *infra*, pp. 15a-17a.

STATEMENT OF THE CASE

* The partnership of Oscar Sundberg & Sons (hereinafter referred to as "Sundberg") entered into a contract with Boeing Airplane Company (hereinafter referred to as "Boeing") to do certain painting work at a contract price of $341,569. Performance and payment bonds were furnished, in a penalty of the same amount, on which petitioner, American Surety Company of New York, (hereinafter referred to as "American") was named as surety, guaranteeing completion of the work according to contract, and payment of labor and material bills incurred in connection with the work.

On July 14, 1955, Sundberg notified American that it could not continue the contract work and requested financial assistance. On the same date American advanced $9,000 with the understanding that the sum would be secured by a mortgage; on July 19 an additional $3,077.74 was advanced, with the understanding between American and Sundberg that additional sums would be advanced from time to time to complete the

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* The facts contained in this Statement are taken from the agreed statement of facts appearing at pages 39-42 of the Record filed herewith; and from Exhibit 11 of the Record filed herein, page 76, which was bound out-of-place in the Record, following page 67.

Boeing contract and pay labor and material bills. On the same date, July 19, Sundberg executed an assignment to American of all sums due or to become due from Boeing under the aforesaid contract, and at the same time each of the three partners of Sundberg executed separate mortgages to American (identical in their provisions) on property which each of the three individually owned. In pertinent part the mortgages all stated they were in consideration of the sums already advanced by American, and "in consideration of further advances to be made."

These three mortgages were duly recorded in King County, Washington, on July 20, 1955, and in addition, one of the mortgages was recorded in Island County, Washington, on July 21, 1955.

Subsequent advances were made by American as follows: On July 21, 26, August 2 and 9, the sums of $10,800, $7,200, $3,300 and $2,200, respectively, for which promissory notes were furnished. The notes stated on their face that they were secured by the mortgages described above.

After these advances were made directly to Sundberg, American also paid labor and material bills incurred by Sundberg in connection with the Boeing contract, and paid other expenses connected with completion of the contract work, in a total amount of $127,598.47, the last material bill having been paid on April 5, 1956. The total outlay by American was $163,316.75, of which it recouped mostly from Boeing the sum of $106,747.23, leaving a difference of $56,569.52, for which it obtained a judgment in this proceeding.

The District Director of Internal Revenue for the Seattle District assessed withholding and unemploy-

ment taxes (with penalties and interest) and filed notices of tax lien as follows:*

Tax	Period	Amount of Tax	Lien No.	Assessment Date	Date Notice of Tax Lien Filed King County
Withholding	6/30/55	$22,626.20	SE-1201-55	8/31/55	10/26/55
Withholding	9/30/55	16,105.99	SE-1430-55	11/30/55	1/ 4/56
Withholding	12/31/55	3,045.08	SE- 321-56	3/ 8/56	3/21/56
Unemployment	1955	1,380.35	SE- 457-56	3/23/56	4/18/56
Unemployment (add'l)	1955	756.99		7/15/57	

It will be observed that the date of recordation of the mortgage (July 20, 1955) antedated both the earliest assessment date (August 31, 1955) and the earliest notice of lien (October 26, 1955).

The Court below worked out a schedule of priorities based on what seems to petitioner an erroneous legal premise. The schedule is set forth in the opinion of the Court (See Appendix A, *infra*, pp. 12a-13a). The schedule is based on the theory that the mortgage involved in this case was a lien, part choate and part inchoate, choate so far as money actually advanced by American prior to the date of an intervening notice of lien is concerned, but inchoate as to money advanced subsequent to the date of notice of an intervening lien.

Petitioner submits that a conventional mortgage, such as the lower Court found this to be, is not in the category of liens falling under Sections 6321-22 of the Code, and subject to the choateness test. A mortgage is a transfer of property, and it falls within the exception stated in Section 6323 (a) of the Code, and thus is not subject to the choateness test.

* The following amounts reflect payments made by the taxpayer after the assessment date.

REASONS FOR GRANTING THE WRIT

I

The main question presented here has not been previously determined by this Court, and it involves an important provision of the federal revenue laws that needs uniform application throughout the country. The Supreme Court of the State of Washington has erroneously construed Sections 6321-22-23 (a) of the Internal Revenue Code, 1954, thinking the conclusion it reached was compelled by the decisions of this Court in such cases as *United States* v. *Security Trust & Saving Bank,* 340 U.S. 47 (1950); *United States* v. *City of New Britain,* 347 U.S. 81 (1954); *United States* v. *Acri,* 348 U.S. 211 (1955); *United States* v. *Scovil,* 348 U.S. 218 (1955); *United States* v. *Colotta,* 350 U.S. 808 (1955); *United States* v. *White Bear Brewing Co.,* 350 U.S. 1010 (1956); *United States* v. *Vorreiter,* 355 U. S. 15 (1957); *United States* v. *Ball Construction Co., Inc.,* 355 U.S. 587 (1958). In reaching its conclusions the Court below also leaned heavily on the decisions in *United States* v. *Bond,* (4 Cir) (1960) 279 F(2) 837; and *United States* v. *Christensen,* (9 Cir) (1959) 269 F(2) 624.

Most of the previous decisions of this Court cited above dealt with Sections 6321-22 of the Revenue Code, whereas this case involves Section 6323 (a). In the previous cases the Court was dealing with the priority of the federal tax lien as compared with state-created liens such as mechanics liens, attachments, landlord's liens, and the like. The Circuit Court decisions which the Court below chose to follow involved factual circumstances closer to those presented here, as did the decision of this Court in *Ball Construction Company, supra,* but even so there are controlling differences

which distinguished this case. The last-mentioned cases either did not involve a conventional mortgage, or there were complicating factors connected with the necessity for the mortgage to pay delinquent taxes, or attorneys' fees, that took the cases out of what might be termed the classic category of a mortgage.

The type of mortgage involved here (Appendix C, *infra*, pp. 17a-18a) has been recognized by Washington courts (including the lower Court in this case) as valid to secure future advances against subsequent liens or encumbrances since 1899, when the Supreme Court of the State of Washington decided *Home Savings & Loan Association* v. *Burton* 20 Wash. 688, 698; 56 P. 940. For later cases to the same effect: *Eltopia Finance Co.* v. *Colley*, (1923) 126 Wash. 554, 219 P. 24, and *Carey* v. *Herrick*, (1928) 146 Wash. 283, 263 P. 190.

This Court likewise recognized the conventional character of a mortgage to secure future advances as early as 1828, when it said in *Conard* v. *Atlantic Insurance Co.*, 26 U.S. (1 Pet.) 386, 448, "First, it is said that this debt upon a *respondentia* bond is of too contingent a nature to uphold a mortgage, as collateral security for the payment of it. We know of no principle or decision that justifies such a conclusion. *Mortgages may as well be given to secure future advances and contingent debts, as those which already exist, and are certain and due.*" (Emphasis supplied)

Since the instrument under consideration here is a mortgage, it necessarily comes within the exception stated in Section 6323 (a) of the Internal Revenue Code, and is not affected by a subsequently filed and recorded tax lien. Or to state it another way, it is not such a competing "lien" with the tax lien as would give

rise to the application of the choateness doctrine. This choateness doctrine applies to competing liens under Section 6321-22, not to exceptions enumerated in Section 6323 (a).

II

The Court below has erred in treating the present instrument as a lien and nothing more. The opening sentence of the decision refers to it as a lien: "The issue here is whether a mortgage was made to secure future advances and, if it was, whether United States tax liens take priority over the mortgage lien as to advances made subsequent to the filing of the United States tax lien."

It is well-known that a conventional mortgage is more than a lien. This Court said in *Conrad* (page 441):

> "* * * The same doctrine may be deduced from the case of *United States* v. *Fisher*, (2 Cranch 358) where the Court declared, that 'no *bona fide* transfer of property in the ordinary course of business is overreached by statutes;' and 'that a mortgage is a conveyance of property, and passes it conditionally to the mortgagee.' If so plain a proposition required any authority to support it, it is clearly maintained in *United States* v. *Hooe*, (3 Cranch 78). It is true, that in discussions in Courts of Equity, a mortgage is sometimes called a lien for a debt. And so it certainly is, and something more; it is a transfer of the property itself, as security for the debt."

Since a mortgage constitutes a transfer of property rather than a lien, and because of the express language of the section itself, it falls within Section 6323(a), and is outside the choateness rule customarily applied to competing liens under Sections 6221-22.

III

The Court below likewise erred in failing to apply the doctrine announced by this Court in *Aquilino* v. *United States* (1960) 363 U.S. 509 and *United States* v. *Durham Lumber Co.*, (1960) 363 U.S. 522, although the same lower Court, in a decision preceding this one by only a few months, correctly applied the rule of *Aquilino*, in *Johnson Service Company* v. *Roush*, (1960) 355 P (2) 815. If this mortgage is more than a lien, and constitutes a transfer of the real property, then the real property was not available to pay the taxes of the taxpayer. It was not his property for this purpose. *Morgan* v. *Commissioner*, 309 U.S. 78; *United States* v. *Bess*, 357 U. S. 51. In any event, according to *Aquilino* and *Durham* it was incumbent upon the Court below to make a finding regarding the property interest of the taxpayer in the real estate before judging competing liens according to the choateness test. This it did not do.

IV

If it be assumed, for the purpose of argument only, that petitioner held nothing but a lien, that it did not hold a mortgage, and that the principle of "first in time is first in right" *(New Britain case)* applies, then an additional point needs consideration. What this doctrine means under the present decisions is that the first choate lien takes precedence over subsequent choate liens.

In the present case American made advances to Sundberg, prior to the date the tax lien was recorded, far in excess of that allowed by the Court. The amount of these prior advances was reduced by the Court on the theory that in the interim American received cer-

tain monies from Boeing that should be treated as repayment by Sundberg of mortgage-secured debts.

It will be remembered that in addition to the direct advances made to Sundberg, for which notes were obtained, American also paid labor and materialmen directly in substantial amounts. In turn, American received from Boeing contract payments and retained percentage in substantial amounts.

The Court below held that on the theory of "first in first out" this money received from Boeing must be applied first against the earliest advances made to American. This had the effect of wiping out the priority of most of the initial advances made by American prior to the initial filing date of the tax lien, and moving the tax lien to the front position. In other words, by thus allocating the income received by American, the Court altered the normal application of the "first in time is first in right" rule.

What made it so wrong to do so in this case was the fact that the money received by American was already its own money. It could not be made the subject of allocation by the Court, on the theory that American was receiving a repayment of mortgage-secured money from Sundberg. At the time Sundberg executed the mortgage in question, it at the same time and on the same date, July 19, 1955, likewise executed an assignment to American of all monies due or to become due under the Sundberg contract with Boeing. Aside from this, and by operation of law, beneficial title to these contract monies had become the property of American at the time it received the payments from Boeing. Since American had by this time paid labor and material bills in large amounts, it was, in law, subrogated to all of Sundberg's right, title and interest in the

money. This is the law of the State of Washington (*Levinson* v. *Linderman*, (1958) 51 Wash 2nd 855, 322 P. (2) 863, 868; *Johnson Service Company* v. *Roush*, (1960) 355 P. (2) 815), and it has been so recognized by this Court on many occasions. *Henningsen* v. *U. S. F. & G. Co.*, 208 U.S. 404; *Prairie State Bank* v. *United States*, 164 U.S. 227; *American Surety Company* v. *Sampsell*, 327 U.S. 269.

Since this income to American from Boeing was already American money by reason of the express assignment and by operation of law, the Court below was in basic error when it dissolved American's priority in time on the theory that this was Sundberg money that should and could be immediately applied to the payment of the earliest mortgage-secured advances.

The mortgage secured all advances made by American, whether directly to Sundberg, or on his behalf directly to labor and materialmen. But the monies coming from Boeing had been made the subject of an assignment, both express and by operation of law, and so could not be regarded as free money available for allocation by the Court.

If the mortgage is to be treated as a lien, then it should be allowed the benefits of the "first in time is first in right" rule, to the extent it was choate, without diminution by the Court in the manner described above.

V

Petitioner also makes the point that the Government failed to file its notices of lien in accordance with the requirement of the statute. The real property covered by the mortgages was in the name of the individual partners in each case. The notices admittedly named the partnership only.

Here, too, is a question that seems never to have been determined by this Court, involving the proper application of Sections 6321 and 6303 (a), Internal Revenue Code, 1954, which states in part that notice shall be given "to each *person* liable for the unpaid tax." (Emphasis supplied) Whether notice to a partnership is sufficient to bind the real property of each person who is a member of the partnership is the question. The Supreme Court of the State of Washington has decided this question in the affirmative. A uniform construction of the revenue laws of the United States would seem to require a determination of this federal question by this Court. In this connection see *Little Lake Lumber Co.* v. *Baugh*, decided by the Ninth Circuit Court of Appeals, October 18, 1961, Case No. 17230, wherein under closely analogous circumstances the Court held that the notice was insufficient to bind the partnership. Also see *United States* v. *Worley*, Cir 6, 213 F(2) 509.

CONCLUSION

For the foregoing reasons this petition for writ of certiorari should be granted.

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November 27, 1961

APPENDIX A

IN THE SUPREME COURT OF THE
STATE OF WASHINGTON

No. 35582

Department One

Filed June 22, 1961.

AMERICAN SURETY COMPANY OF NEW YORK,
a corporation, *Respondent*,

v.

OSCAR SUNDBERG ET AL., *Defendants*,

THE UNITED STATES OF AMERICA, *Appellant*.

The issue here is whether a mortgage was made to secure future advances and, if it was, whether United States tax liens take priority over the mortgage lien as to advances made subsequent to the filing of the United States tax liens. There are also questions raised as to the validity of the United States tax liens and the effectiveness of the notice given.

In February, 1955, Oscar Sundberg, Thor Sundberg, and Carl Sundberg (doing business as Oscar Sundberg and Sons, a partnership) entered into a contract with the Boeing Airplane Company to do certain painting for the sum of $341,569. The Sundbergs, as principals, entered into a performance bond with the American Surety Company, hereinafter referred to as the surety, by the terms of which, if the Sundbergs were unable to perform the contract, the surety was required to complete it or cause it to be done.

July 14, 1955, the Sundbergs being without sufficient funds to meet labor expenses, the surety advanced $9,000 to them, it being agreed that this sum would be secured by a mortgage.

July 19, 1955, the Sundbergs obtained another advance of $3,077.74; Thor Sundberg, on behalf of himself and the other partners, assigned to the surety all of their claims

against Boeing; and each of the Sundbergs executed mortgages in favor of the surety on real property which they individually owned. Three of the mortgages were recorded in King County on July 20, and the fourth in Island County on July 21. The mortgages, which were practically identical except for the mortgagor's name and the property described, stated that they were made in consideration of the $9,000 advanced July the 14th:

> "• • • and in further consideration of the advance at this time of Three Thousand and Seventy-Seven and 74/100 ($3,077.74) Dollars, *and in consideration of further advances to be made,* and to secure the total sum now advanced amounting to Twelve Thousand and Seventy-Seven and 74/100 ($12,077.74) Dollars, according to the terms of promissory note bearing date of July 19, 1955, • • •" (Emphasis supplied.)

July 21, the Sundbergs received a further advance of $10,863.37. A promissory note was given on that date to the surety in the sum of $22,941.11 (the sum of the advances made July 14, 19, and 21).

Additional advances were made to the Sundbergs on July 26, August 2 and 9; the amounts being $7,254.14, $3,314.58, and $2,208.45 respectively. A separate note was given for each of these advances. No other notes were given to the surety and no further advances were made direct to the Sundbergs. Each of these notes, together with the earlier note for $22,941.11, was signed by all of the partners. Each note provided for interest at five and one-half per cent until maturity and six per cent thereafter, and for a reasonable attorney's fee in the event of suit thereon. Each note also stated that it was "secured by mortgages on real estate and a chattel mortgage on personal property." (The record in this case is silent as to any chattel mortgage. The notes have no significance except as they bear on the question as to whether the mortgages were to secure future advances, as the action brought by the surety is clearly not an action on the notes.)

The surety made payments after August 9 (totalling $127,598.47), most of them directly to materialmen (the

last payment for material being on April 5, 1956, from which date the interest allowed by the judgment is computed). This included also payments in the sum of $11,175.31 to attorneys (made during 1957 and 1958[1]) and $130 for title reports made November 28, 1958, less than a month before these foreclosure proceedings were commenced. However, no specific item is questioned and the total amount which the surety had to pay to complete the contract is conceded to be $163,316.75.

The surety brought this action, asking for a judgment for the difference between the sum total of the payments made to complete the contract and the credits and payments it received on account of the contract (mostly from the Boeing Airplane Company), totalling $106,747.23.

The amount thus received by the surety must be credited on the first $106,747.23 advanced by the surety to complete the contract.[2] The judgment against the Sundbergs is for the portion remaining unpaid, $56,569.52. This amount was all advanced by the surety on or after December 6, 1955, as shown by the schedule of payments (exhibit No. 11), conceded to be correct.

Prior to December 6, 1955, the United States had assessed withholding taxes[3] against Oscar Sundberg and Sons in the sum of $22,626.20, payment of which was not made although notice and demand was made therefor. A notice of this tax lien was filed in the auditor's office of King County October 26, 1955, and in the auditor's office of Island County on February 17, 1959.

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[1] This general statement is subject to the exception that $650 of the attorney's fees was paid December 13, 1955.

[2] Bellingham Securities Syndicate, Inc. v. Bellingham Coal Mines, Inc., 1942, 13 Wash. 2d 370, 125 P. 2d 668; Whiting v. Rubinstein, 1941, 10 Wash. 2d 5, 116 P. 2d 305; Diettrich Bros. Inc. v. Anderson, 1935, 183 Wash. 574, 48 P. 2d 921; Restatement, Contracts, 743, § 394.

[3] "Withholding" taxes are imposed on wages pursuant to §§ 3401-3404 of the Internal Revenue Code of 1954. 26 U.S.C.A. (1958 ed.) 3401-3404.

The United States claimed priority in the proceeds of the sale of the mortgaged property in King County, not only for this tax lien which was assessed and notice thereof filed in King County prior to the payment of any portion of the $56,569.52, for which the surety has judgment, but for other tax liens listed as follows:

Tax	Outstanding amount of tax	Assessment date	Notice of tax lien filed in King County	Notice of tax lien filed in Island County
Withholding	$16,105.99	11-30-55	1- 4-56	2-17-59
Withholding	3,045.08	3- 8-56	3-21-56	2-17-59
Unemployment[4]	1,380.35	3-23-56	4-18-56	2-17-59
Unemployment	756.99	7-15-57		2-17-59

The trial court, after entering judgment for the surety against the Sundbergs in the sum of $56,569.52, entered a decree foreclosing the mortgages and ordered that the property covered by the mortgages be sold and that the proceeds of the sale of the King County property be applied in the following order of priority: (1) The surety's judgment, together with interest and a $5,600 attorney fee; (2) a United States tax lien for $22,626.20, with interest, notice of which was filed in King County October 26, 1955; (3) a United States tax lien for $16,105.99, with interest, notice of which was filed in King County January 4, 1956; (4) B. F. Tilley's judgment for $4,649.88, with interest, entered in King County March 6, 1956; (5) the remaining tax liens of the United States for $3,045.08 and $1,380.35, with interest, notice of which was filed in King County March 21, 1956, and April 18, 1956, respectively; and a tax assessed July 15, 1957, in the amount of $756.99 with interest, no notice of which was filed in King County.

The United States appeals, so far as the priorities to the proceeds of the mortgaged property in King County are

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[4] "Unemployment" taxes are imposed by the Federal Unemployment Tax Act, §§ 3301-3308 of Internal Revenue Code of 1954. 26 U.S.C.A. (1958 ed.), §§ 3301-3308.

concerned, urging that the mortgages given by the Sundbergs to the surety were not effective to secure future advances as against the claim of its intervening liens and that, in any event, its lien for $22,626.20 had first priority on the proceeds of the sale.

We will, however, first consider the contentions made by the surety as to the validity of the tax lien and the effect of the notice filed. It was urged at the trial court level that since the tax lien notices, which were filed as required by § 6323 of the Internal Revenue Code of 1954 (26 U.S.C.A. (1958 ed.), § 6323), used the name of Oscar Sundberg and Sons, they were not effective as notice of the government's liens on property belonging to the individual partners.

This issue was disposed of adversely to the surety by the trial court. It appears to raise the same issue in this court under the heading in its brief "Tax Lien Notices Were Invalid," and then argues an entirely different proposition, i. e., that there was no lien on the individual property of the partners because the demand for payment of the taxes (required by §§ 6303 and 6321 of Internal Revenue Code of 1954) was not made on the individual partners.

The latter point seems never to have been brought to the attention of the trial court, and, hence, is not properly before this court. However, neither contention has any merit.

§ 6321 of the Internal Revenue Code of 1954 provides for a lien for the taxes under consideration:

> "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. * * *"

§ 6322 of the Internal Revenue Code of 1954 provides for the period of the lien:

> "Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time. * * * "

The surety emphasized the first part of § 6321, i. e., a refusal to pay after demand, as being a prerequisite to a lien, and urges that no demand was made upon the individual partners.

There is no question but that general partners are individually liable for the taxes due the United States from the partnership. 26 U.S.C.A. § 701. Underwood v. United States, 5 Cir., 1941, 118 F. 2d 760.

A demand on the partnership is a demand upon all of the partners and is a sufficient compliance with the terms of both § 6321 and § 6303 of the Internal Revenue Code of 1954,[5] for the purpose of making the taxes assessed a lien on the property of the individual partners.

Such liens are secret liens, but were good under Federal law even as against a subsequent *bona fide* purchaser or an encumbrancer in good faith (United States v. Snyder, 1893, 149 U.S. 210, 13 S. Ct. 846, 37 L. Ed. 705) until in 1913 when Congress acted to protect a mortgagee, purchaser, or judgment creditor (and a pledgee was added in 1939) against

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[5] § 6303 of the Internal Revenue Code of 1954, so far as material, reads:

"(a) General rule.—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address."

such secret liens. See § 6323 of the Internal Revenue Code of 1954, 26 U.S.C.A. § 6323.[6] A notice of the United States liens, using the name of the partnership (Oscar Sundberg and Sons) was notice not only to anyone dealing with Oscar Sundberg, but also to those dealing with Carl and Thor Sundberg or their property, as mortgagee, pledgee, purchaser, or encumbrancer. Richter's Loan Company v. United States, 5 Cir., 1956, 235 F. 2d 753; United States v. Jane B. Corporation, D.C. Mass. 1958, 167 F. Supp. 352. The rule is that the existence, effectiveness, and relative priority of Federal tax liens represent Federal questions. United States v. Rasmuson, 8 Cir., 1958, 253 F. 2d 944; United States v. Acri, 1955, 348 U.S. 211, 75 S. Ct. 239, 99 L. Ed. 264; United States v. Gilbert Associates, Inc., 1953, 345 U.S. 361, 73 S. Ct. 701, 97 L. Ed. 1071; United States v. Security Trust & Savings Bank, 1950, 340 U.S. 47, 71 S. Ct. 111, 95 L. Ed. 53.

While not relevant here, it would seem that such notices were probably adequate under Washington law, since notice sufficient to excite attention and put a person on guard, or to call for an inquiry is notice of everything to which such inquiry might lead. First National Bank of Kelso v. Hart, 1925, 137 Wash. 110, 118, 241 P. 675; Tjosevig v. Butler, 1934, 180 Wash. 151, 38 P. 2d 1022.

Passing from the question of the validity of the tax liens, and the sufficiency of notice thereof, we must, before we

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[6] "(a) Invalidity of lien without notice.—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate.

"(1) Under state or territorial laws.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice;"

(It is conceded that the office of the county auditor is the proper place for the filing of such notices in this state; and that the filings of the notices in that office were on the dates indicated in the opinion.)

take up any consideration of priorities between the tax liens of the United States and the mortgages, first consider the primary issue raised by the United States: Were these actually mortgages to cover future advantages?

The trial court concluded that they were mortgages to secure future advances and, relying on Home Savings & Loan Ass'n v. Burton, 1899, 20 Wash. 688, 56 P. 940; Eltopia Finance Co. v. Colley, 1923, 126 Wash. 554, 219 P. 24, and Carey v. Herrick, 1928, 146 Wash. 283, 263 P. 190, held that the priority related back to the date of the mortgage since the payments made were obligatory rather than optional. Elmendorf-Anthony Co. v. Dunn, 1941, 10 Wash. 2d 29, 116 P. 2d 253, 138 A.L.R. 558.

The United States urges that the rule of relation back should be limited, and in some states it is, to situations where the mortgage fixes a limit to the amount of the advances to be secured or states a definite purpose that is to be accomplished, such as the completion of a building or a contract. One authority says:

> "If the limit be not defined in any way, it can be good only for the advances made at the time, and such others as may afterward be made before any other incumbrances are made upon the property mortgaged. • • • " 1 Jones on Mortgages (8th ed.) 595, § 458.

In the present case, the amount of the advances already made at the time the mortgage was signed was $12,077.74, and while the mortgages stated that they were made "in consideration of further advances to be made," they did not say that they were to secure such advances, but only that they were:

> " • • • to secure the payment of Twelve Thousand and Seventy-Seven and 74/100 ($12,077.74) Dollars so advanced according to the terms of promissory note bearing date of July 19, 1955.[7] • • • "

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[7] There was no note bearing date of July 19th. See pages 2 and 3 for description of the notes delivered by the Sundbergs to the surety.

There was no specific limitation, no mention of the surety contract, or the painting contract, or anything else which would put a searcher of the record on notice that the mortgage might cover advances of over $160,000.

However, we cannot agree with the United States that these mortgages were not made to secure the advances made and to be made by the surety in the completion of the contract. The mortgages were made on the same day (July 19, 1955) that the partnership assigned[8] all of their claims against Boeing to the surety. The four notes made by the Sundbergs, to which we have referred, were all subsequent to the mortgage and all recited that they were "secured by mortgages on real estate and a chattel mortgage on personal property"; and the mortgages being foreclosed were the only mortgages executed, insofar as the record discloses. As between the parties, these were mortgages to secure future advances, and we think that the statement in the mortgages—that they were made in consideration of advances thereafter to be made—is sufficient notice to subsequent encumbrancers that they were intended to secure future advances.

We come now to the consideration of whether the lien of the mortgages for future advances was prior or subordinate to the lien for United States taxes, the notices of which were filed after the mortgages but before certain future advances were made.

There can be no question but that under Washington law, if the mortgages were made to secure future advances, the trial court was eminently justified in its determination that all advances under the mortgages related back, so far as the lien was concerned, to the date of the mortgage. This position is supported by substantial authority as pointed

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[8] It was strenuously urged that such an assignment itself constituted a mortgage (under § 6323) in United States v. R. F. Ball Construction Co., 1958, 355 U.S. 587, 78 S. Ct. 442, 2 L. Ed. 2d 510, and a United States District Court and Circuit Court so held. The Supreme Court of the United States, with four judges dissenting, held that the assignment was not a mortgage.

out in 4 Pomeroy's Equity Jurisprudence (5th ed.), § 1199, p. 596:

> "Finally, there are decisions by most able courts which give the prior mortgage to secure future advances an absolute preference; which maintain the mortgagee's supremacy, and preserve the lien of his mortgage against intervening subsequent encumbrances, even for advances made after receiving actual notice of such encumbrances. This conclusion is based upon the doctrines that the executory agreement of the mortgagee creates a full and perfect lien in equity, effectual against all persons who are charged with notice thereof, and that the record of the mortgage furnishes such a notice affecting all subsequent encumbrances."

However, "most able courts" must bow to the reality that the United States is not to be frustrated in the collection of revenue by the tax priority laws of fifty different states. The relative priority of the tax liens of the United States presents a Federal question to be determined by the Federal courts. United States v. Security Trust & Savings Bank, supra; United States v. Acri, supra; People of State of Illinois ex rel. Gordon v. Campbell, 1946, 329 U.S. 362, 371, 67 S. Ct. 340, 91 L. Ed. 348.

For a competing lien to take precedence over a Federal tax lien, it must not only be prior in point of time but it must also be perfected and choate.

It was in a case from this state[9] that the United States Supreme Court "launched the doctrine of the inchoate and general lien."[10] The competing lien must be definite (and not merely ascertainable in the future) in at least three respects as of the crucial time (the filing of the notice of the lien for United States taxes required by § 6323): identity of lienor, amount of the lien, and the property to which it

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[9] Spokane County v. United States, 1929, 279 U.S. 80, 49 S. Ct. 321, 73 L. Ed. 621.

[10] 63 Yale Law Journal 911 (1954).

attaches. People of State of Illinois ex rel. Gordon v. Campbell, supra.

As pointed out in United States v. Ringler, D.C.N.D. Ohio 1958, 166 F. Supp. 544, the United States Supreme Court has not, as yet, passed upon the question involving the relative priority of a tax lien and a mortgage to secure future advances, where the tax lien was filed subsequent to the recording of a mortgage given to secure future advances but prior to advances for which a lien is claimed.

In the Ringler case, the mortgage was limited in amount to $20,000 and was to secure the payment of attorney's fees for services to be thereafter rendered. The mortgage was recorded June 18, 1953, and the notice of lien for United States taxes filed August 5, 1953. In an action to foreclose the tax lien (the taxes amounting to more than the value of the mortgaged property), the evidence was that the value of the legal services rendered the mortgagor, after the mortgage, was about $10,000 and that the value of the services rendered between June 18, 1953, and August 5, 1953, was $1,600. The court, after stating the rule (applied by the trial court in this case) that a mortgage to secure future advances which the mortgagee is obligated to make, takes priority over a subsequent lien recorded before the future advances were made, said (at page 548):

> "• • • However, whenever a question involving the relative priority of United States tax liens and other liens arises, courts are required to apply the test of choateness to the competing liens. Applying that test here, it must be held that as to the indefinite future advances (in the form of legal services) which were to be made after August 5, 1953, the mortgage lien is subordinate to the tax lien of the United States. The lien of the mortgage securing the value of services rendered between June 18, 1953 and August 5, 1953 stands on a different footing. As shown by the record, on August 5, 1953, legal services of the value of $1,600 had been rendered by the mortgagees in reliance upon the security of the mortgage. To that extent, therefore, the mortgage lien was not inchoate or imperfect.

I am of the opinion that as to the amount of the mortgage lien securing such indebtedness the rule of first in time—first in right, applies. * * * "

Because of the lack of certainty as to whether future advances would be made and, if so, the amount thereof, the lien priority cases from this court relied upon by the trial court are inapplicable insofar as the liens of the United States for taxes are concerned.

Priority here is governed, so far as the United States tax liens are concerned, by the rationale of those Federal cases which hold that the lien of a prior mortgage must be subordinated to Federal tax liens where the mortgage lien is inchoate at the time the notice of the Federal tax lien is filed. United States v. Bond, 4 Cir., 1960, 279 F.2d 837; United States v. Christensen, 9 Cir., 1959, 269 F.2d 624; United States v. Ringler, supra; see also Metropolitan Life Insurance Company v. United States, 1959, 9 A.D.2d 356, 194 N.Y.S.2d 168, applying the Federal law.

Thus the priorities, as they relate to the property in King County covered by the mortgages foreclosed in this action, would be:

(1) The United States tax lien, notice of which was filed for record on October 26, 1955, prior to the advancement of any portion of the last $56,569.52 advancement by the surety	$22,626.20
(2) The lien of the mortgage for that portion of the last $56,569.52 advanced by the surety, which was advanced between October 26, 1955, and January 4, 1956, when notice of the second of the United States tax liens was filed for record	25,376.35
(3) The United States tax lien, notice of which was filed for record January 4, 1956	16,105.99
(4) The lien of the mortgage for that portion of the advances made by the surety be-	

tween January 4, 1956 and March 21, 1956, when notice of the third of the United States tax liens was filed for record	9,775.57
(5) The United States tax lien, notice of which was filed for record March 21, 1956 ..	3,045.08
(6) The United States tax lien, notice of which was filed for record April 18, 1956 ..	1,380.35
(7) The lien of the mortgage for the remainder of the advances made by the surety after the notice of the United States tax lien was filed for record April 18, 1956	21,417.60
(8) Lien of the B. F. Tilley judgment,[11] entered March 6, 1956, together with interest and costs	4,649.88
(9) The unrecorded United States tax lien assessed July 15, 1957, but not filed for record in King County	756.99

Each of the government's liens would carry with it the penalties and accrued interest; each segment of the mortgage lien would carry with it accrued interest, as would the B. F. Tilley judgment.

The order of priority with reference to the proceeds of the sale of the Island County property is quite different, as all of the advances under the mortgage were made prior to the filing of the Federal tax liens in that county, February 17, 1959. Hence, the lien of the mortgages in the sum of $56,569.52 was a choate lien before notice of any United States tax lien was filed, and would, therefore, come first—followed by the United States tax liens. The F. B. Tilley

[11] The lien of this judgment would, under the Federal rule, take precedence over United States tax liens, of which notice was not recorded, until after its entry; however, under our decisions it would be subordinate to the lien of the mortgage. Our decisions control the priorities between the mortgage and the judgment.

judgment was not filed in that county. The trial court is affirmed as to order of priority, so far as the proceeds of the sale of the Island County property are concerned.

There is a further question, perhaps academic, as to the status of the $5,600 attorney fee, made a part of the judgment. The United States contends that an attorney's fee for the foreclosure of a prior mortgage, although provided for in the mortgage, cannot come ahead of its liens. We do not have to reach that question, as there is no provision in the mortgages for an attorney's fee.

As we have pointed out, almost $12,000 in attorney's fees was included in the cost of completing the contract and is not questioned. The additional $5,600 had nothing to do with the completion of the contract, but was for securing the present judgment against the Sundbergs and establishing the priority of the various liens against the mortgaged property. The four promissory notes each refer to an attorney's fee, but, as we have already pointed out, this action is not on the notes but to recover the difference between $163,316.75, expended in completing the contract, and $106,747.23 received on account of the contract, i.e., $56,569.52. The basis, if any, for a contractual attorney's fee in this action is found in the application for the bond, which is not in the record.

The pre-trial order stated, and the trial court found, that Oscar Sundberg and Sons by their application for a bond agreed to pay, in the event of action, reasonable attorney's fees. Not being provided for in the mortgages, this attorney's fee became a charge on the mortgaged property solely by reason of the judgment of January 15, 1960, and is subsequent to all other liens so far as the mortgaged property is concerned, except possibly the tax lien for $756.99, of which, so far as the record discloses, no notice has yet been recorded in King County.

The trial court is directed to modify the judgment in the respects herein indicated.

The United States, having secured very substantial relief on this appeal, will recover its costs herein to be taxed.

HILL, J.

WE CONCUR:

FINLEY, C. J.
WEAVER, J.
ROSELLINI, J.
FOSTER, J.

APPENDIX B

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.
(26 U.S.C. 1958 ed., Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.
(26 U.S.C. 1958 ed., Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) Invalidity of Lien Without Notice.—Except as otherwise provided in subsection (c), the lien imposed

by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) Under state or territorial laws.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) With clerk of district court.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) With clerk of district court for District of Columbia.—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) Form of Notice.—If the notice filed pursuant to subsection (a) (1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a) (2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) Exception in Case of Securities.—
(26 U.S.C. 1958 ed., Sec. 6323.)

SEC. 6303. NOTICE AND DEMAND FOR TAX.

(a) General rule.—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment

thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

APPENDIX C

Mortgage

THE MORTGAGOR, OSCAR SUNDBERG, the owner of the property hereinafter described, as his sole and separate property, mortgages to AMERICAN SURETY COMPANY OF NEW YORK, in consideration of an advance of the sum of Nine Thousand ($9,000.00) Dollars, advanced on July 14, 1955, with the understanding that the same would be secured by a mortgage, and in further consideration of the advance of Three Thousand and Seventy-Seven and 74/100 ($3,077.74) Dollars made at this time, and further advances to be made, and to secure the payment of Twelve Thousand and Seventy-Seven and 74/100 ($12,077.74) Dollars so advanced according to the terms of promissory note bearing date of July 19, 1955, the following described real estate situated in the County of King, State of Washington, to-wit:

> Lot 11 in Block 8 in Fairview Homestead Association for the Benefit of Mechanics and Laborers, in the City of Seattle, Washington.

And the mortgagor promises and agrees to pay before delinquency all taxes, special assessments and other public charges levied, assessed or charged against said described premises, and to keep all improvements on said described premises insured against loss or damage by fire for its full, insurable value, for the benefit of the mortgagee and to deliver all policies and renewals to the mortgagee.

In case the mortgagor shall fail to pay any installment of principal or interest secured hereby when due or to keep or perform any covenant or agreement aforesaid, then the

whole indebtedness hereby secured shall forthwith become due and payable, at the election of the mortgagee.

DATED this 19 day of July, 1955.

(Signed) OSCAR SUNDBERG (SEA

STATE OF WASHINGTON }
COUNTY OF KING } ss.

On this day personally appeared before me OSCAR SUNDBERG, to me known to be the individual described in and who executed the within and foregoing instrument, and acknowledged that he signed the same as his free and voluntary act and deed for the uses and purposes therein mentioned.

GIVEN under my hand and official seal this 19 day of July, 1955.

EDWARD BORG
Notary Public in and for the State of Washington, residing at Seattle

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Argument	5
Appendix	10

CITATIONS

Cases:

Aquilino v. *United States*, 363 U.S. 509	7
Baugh, F. B., Inc. v. *Little Lake Lumber Co.* (C.A. 9), decided October 18, 1961	9
Bloomer v. *S. W. Wash. Prod. Cr. Assn.*, 36 Wash. 2d 752, 220 P. 2d 324	8
Hoare v. *United States*, 294 F. 2d 823	7
Illinois v. *Campbell*, 329 U.S. 362	7
Jump v. *North British Etc. Ins. Co.*, 44 Wash. 596, 87 Pac. 928	8
Metropolitan Life Ins. Co. v. *United States*, 9 App. Div. 356, 194 N.Y.S. 2d 168	7
New York v. *Maclay*, 288 U.S. 290	7
Prairie State Bank v. *United States*, 164 U.S. 227	8
Swanson v. *United States*, 156 F. 2d 442, certiorari denied *sub nom. Spokane Portland Cement Co.* v. *Swanson*, 329 U.S. 800	8
Union Machinery & Supply Co. v. *Darnell*, 89 Wash. 226, 154 Pac. 183	8
United States v. *Acri*, 348 U.S. 211	6
United States v. *Ball Construction Co.*, 355 U.S. 587	6, 7
United States v. *Bond*, 279 F. 2d 837, certiorari denied, 364 U.S. 895	5, 7
United States v. *Christensen*, 269 F. 2d 624	7
United States v. *Colotta*, 350 U.S. 808	6

Cases—Continued Page

United States v. *Durham Lumber Co.*, 363 U.S. 522 ... 7
United States v. *Hulley*, 358 U.S. 66 ... 6
United States v. *Liverpool & London Ins. Co.*, 348 U.S. 215 ... 6
United States v. *New Britain*, 347 U.S. 81 ... 6, 7
United States v. *Ringler*, 166 F. Supp. 544 ... 7
United States v. *Scovil*, 348 U.S. 218 ... 6
United States v. *Security Tr. & Sav. Bk.*, 340 U.S. 47 ... 6, 7
United States v. *Union Central Life Insurance Co.*, decided December 18, 1961, No. 52, this Term ... 6
United States v. *Vorreiter*, 355 U.S. 15 ... 6
United States v. *White Bear Brewing Co.*, 350 U.S. 1010 ... 6

Statute:

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):
Sec. 3301–3308 ... 4
Sec. 3401–3404 ... 4
Sec. 6303 ... 2, 9, 10
Sec. 6321 ... 2, 5, 9, 10
Sec. 6323 ... 2, 5, 6, 7, 9, 10

Miscellaneous:

Restatement, *Security*, Sec. 141 ... 8

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 575

AMERICAN SURETY COMPANY OF NEW YORK, PETITIONER

v.

SUNDBERG & SONS, ET AL., AND THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WASHINGTON

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The memorandum decision of the Superior Court of King County, Washington, is not reported. The opinion of the State of Washington Supreme Court (Pet. 1a–15a) is reported at 363 P. 2d 99.

JURISDICTION

The petition for rehearing of the decision below was denied on August 29, 1961, and judgment was entered by the Supreme Court of Washington on August 31, 1961. The petition for a writ of certiorari was filed on November 27, 1961. The jurisdiction of this Court is invoked pursuant to the 28 U.S.C. 1257.

QUESTION PRESENTED

Whether federal tax liens take priority over a mortgage purporting to secure future advances, when the advances were not made until after notice of the tax liens was filed.

STATUTES INVOLVED

The statutes involved, Sections 6303, 6321, and 6323 (a) and (b) of the Internal Revenue Code of 1954, are set forth in the Appendix, *infra*, pp. 10–11.

STATEMENT

In February, 1955, Oscar Sundberg, Thor Sundberg, and Carl Sundberg, doing business as Oscar Sundberg and Sons, a partnership, entered into a contract with the Boeing Airplane Company to do certain painting for the sum of $341,569. The Sundbergs, as principals, entered into a performance bond with the American Surety Company providing that, if the Sundbergs were unable to perform the contract, the surety was required to complete it. (Pet. 1a.)

On July 14, 1955, the Sundbergs were unable to continue performance of the contract because they did not have sufficient funds to meet labor expenses. At their request, the surety advanced $9,000 to them; it was agreed that this sum would be secured by a mortgage. On July 19, 1955, the Sundbergs obtained another advance of $3,077. That day Thor Sundberg, on behalf of himself and the other partners, assigned to the surety all of their claims against Boeing; the Sundbergs also executed mortgages in

favor of the surety on real property which each individually owned. Three of the mortgages were recorded in King County, Washington, on July 20, 1955, and the fourth in Island County on July 21, 1955. The mortgages, which were practically identical except for the mortgagor's name and the property described, stated that they were in consideration of the $9,000 advanced July 14th (Pet. 1a–2a, 17a):

> * * * and in further consideration of the advance at this time of Three Thousand and Seventy-Seven and 74/100 ($3,077.74) Dollars, and in consideration of further advances to be made, and to secure the total sum now advanced amounting to Twelve Thousand and Seventy-Seven and 74/100 ($12,077.74) Dollars, according to the terms of promissory note bearing date of July 19, 1955, * * *.

Additional advances were made until August 9, 1955, for which the Sundbergs gave their joint notes. Subsequent to August 9, 1955, the surety's advances were not made directly to the Sundbergs but were made to materialmen and others; the Sundbergs gave the surety no notes after that date. (Pet. 2a.)

The total amount advanced by the surety to complete the contract was $163,316. The surety received credits and payments on account of the contract in the amount of $106,747. The amount advanced by the surety for which it did not receive reimbursement was therefore $56,569. (Pet. 2a–3a.)

The United States assessed withholding taxes, federal unemployment taxes, and penalties and interest

against Oscar Sundberg and Sons. The taxes were assessed and notices of lien were filed in King County as follows (Pet. 3a, 4a):

Tax	Amount of tax	Assessment date	Date notice of tax lien filed in King County
Withholding [1]	$22,626	8/21/56	10/26/56
Withholding [1]	16,106	11/20/56	1/ 4/56
Withholding [1]	3,045	2/ 5/56	3/21/56
Unemployment [2]	1,380	2/22/56	4/18/56
Unemployment [2]	757	7/15/57	

[1] Withholding taxes are imposed on wages pursuant to Sections 3401–3404 of the Internal Revenue Code of 1954 (26 U.S.C. 3401–3404).

[2] Unemployment taxes are imposed by the Federal Unemployment Tax Act, Sections 3301–3309 of the Internal Revenue Code of 1954 (26 U.S.C. 3301–3309).

Notice of the above tax liens was also filed with the auditor of Island County, Washington, on February 17, 1959. Despite demand by the District Director, the taxes were not paid. (Pet. 3a–4a.)

The surety instituted this action in the Superior Court of King County, Washington, to foreclose on the mortgages given by each of the Sundbergs naming as parties the United States and others who had or claimed an interest in the properties.[1] The trial court, after entering judgment for the surety in the amount of $56,569 against the Sundbergs, made a decree foreclosing the mortgages and ordered that the proceeds of the King County property be applied first in payment of the surety's judgment prior to satisfaction of any of the liens of the United States. Upon the government's appeal, the court

[1] Although the surety's petition in this Court titles the case with the partnership name, the partnership is not now and has never been a party to this action.

below modified this order of priority as to the proceeds of the King County property. The court found that all of the $56,569 remaining unpaid had been advanced in installments on or after December 6, 1955, and after all or part of the federal taxes had been assessed and notices of lien filed.[2] (Pet. 3a–4a.) It held that the liens of the mortgages were subordinate to the tax liens insofar as they secured advances made after notice of the tax lien had been filed and were prior to the tax liens insofar as they secured advances made before filing of the tax liens. (Pet. 9a–13a.)

ARGUMENT

Section 6321 of the 1954 Internal Revenue Code (Appendix, *infra*, p. 10) imposes a lien in favor of the United States on all of the property of a person liable to pay any tax who fails to pay after demand. Section 6323(a) (Appendix, *infra*, p. 10) provides that this lien is not valid against a mortgagee (among others) until notice of the lien has been filed.

The surety argues (Pet. 6–8) that the interests described in Section 6323(a) are entitled to priority over any subsequently filed federal tax lien, whether or not choate when the federal lien attaches. This argument, which was the basis of the dissenting opinion in *United States* v. *Bond*, 279 F. 2d 837, 848 (C.A. 4), certiorari denied, 364 U.S. 895, mis-

[2] An exception is a tax lien for $757, not in controversy. (Pet. 4a, 13a.) No issue is raised here or was below as to the order of priority of the proceeds of the Island County property since all advances by the surety were made prior to the filing of notices of tax lien in that county. (Pet. 4a–5a, 13a.)

construes the purpose and effect of Section 6323. The general rule for priority of liens where a federal tax lien is asserted is that a lien under state law which arises and is choate and perfected prior to the time the federal tax lien arises is also prior in right.[5] Section 6323 does not create for mortgage liens an exception to the general rule that priority in time depends upon the time at which a lien becomes choate. It is designed to give priority to mortgage liens even though they arise at a later date than the federal tax lien if the mortgagee was without notice of the federal lien at the time the mortgage lien became choate. It accomplishes this purpose by making the date of recording the effective date of the federal tax lien as against mortgagees. See *United States* v. *Union Central Life Insurance Co.*, decided December 18, 1961, No. 52, this Term. Thus, a mortgage lien is prior in right to a federal tax lien if, but only if, it is perfected and choate prior to the time that notice of the federal lien is filed pursuant to Section 6323. *United States* v. *Ball Construction Co.*, 355 U.S. 587.

The court below correctly applied well-established principles in holding that the surety's mortgage liens on the King County properties became choate only after the advances secured by the mortgages were

[5] See *United States* v. *Security Tr. & Sav. Bk.*, 340 U.S. 47; *United States* v. *New Britain*, 347 U.S. 81; *United States* v. *Acri*, 348 U.S. 211; *United States* v. *Liverpool & London Ins. Co.*, 348 U.S. 215; *United States* v. *Scovil*, 348 U.S. 218; *United States* v. *Galotta*, 350 U.S. 808; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010; *United States* v. *Vorreiter*, 355 U.S. 15; *United States* v. *Ball Construction Co.*, 355 U.S. 587; *United States* v. *Hulley*, 358 U.S. 66.

made since only then was the lien fixed in amount. *United States* v. *Ball Construction Co.*, 355 U.S. 587; *United States* v. *Security Tr. & Sav. Bk.*, 340 U.S. 47.* No doctrine of "relation back" may be recognized. *United States* v. *Security Tr. & Sav. Bk., supra; New York* v. *Maclay*, 288 U.S. 290. By the time the mortgage lien became choate the federal tax lien had already been made effective against the mortgagee by the filing of the notice required by Section 6323(a). The federal lien was therefore properly accorded priority by the court below.

The decision below accords with the principles enunciated by this Court and further finds direct support in the decisions of those courts which have passed on the question, including one in which certiorari was denied last term. *United States* v. *Bond*, 279 F. 2d 837 (C.A. 4), certiorari den' 364 U.S. 895; *United States* v. *Christensen*, 269 l .4 (C.A. 9); *United States* v. *Ringler*, 166 F. S . .4; *Metropolitan Life Ins. Co.* v. *United* . es, 9 App. Div. 2d 356, 194 N.Y.S. 2d 168. See a so *Hoare* v. *United States*, 294 F. 2d 823 (C.A. 9). Indeed, no conflict with these cases is claimed.

The surety's argument (Pet. 8–9) that the mortgages amounted to transfers of the Sundbergs' properties, leaving them with no interest to which the government's liens could attach, citing *Aquilino* v. *United States*, 363 U.S. 509, and *United States* v. *Durham Lumber Co.*, 363 U.S. 522, is plainly without

* This Court has stated that a competing lien is choate and perfected when the identity of the lienor, the property subject to the lien, and the amount of the lien are all established. *United States* v. *New Britain*, 347 U.S. 81, 84; *Illinois* v. *Campbell*, 329 U.S. 362, 375.

merit. Certainly, it is settled Washington law that a mortgage is merely a lien for the payment of money and that the real property subject to the mortgage remains the property of the mortgagor. *Bloomer* v. *S. W. Wash. Prod. Cr. Assn.*, 36 Wash. 2d 752, 757, 220 P. 2d 324, 327; *Union Machinery & Supply Co.* v. *Darnell*, 89 Wash. 226, 233, 154 Pac. 183, 186; *Jump* v. *North British Etc. Ins. Co.*, 44 Wash. 596, 599, 87 Pac. 928, 929; *Swanson* v. *United States*, 156 F. 2d 442, 448 (C.A. 9), certiorari denied *sub nom. Spokane Portland Cement Co.* v. *Swanson*, 329 U.S. 800.

Similarly, the argument (Pet. 9–11) that the amounts received by the surety as the Sundbergs' assignee (and surety) under the Boeing contract were (Pet. 10) "already its own money" and (Pet. 11) "could not be regarded as free money available for allocation by the Court" is without merit. Although the surety as assignee (and under principles of subrogation) was entitled to the sums due from Boeing under the contract (*Prairie State Bank* v. *United States*, 164 U.S. 227; Restatement, *Security*, Sec. 141) it was manifestly necessary to apply those receipts against the surety's expenditures to determine the amount that the surety was out-of-pocket on the contract, *i.e.*, the amount for which the Sundbergs are liable (and for which their properties stand as security). Contrary to the surety's assertions, there is no question that the court below properly applied the first in time, first in right principle in listing the priority of the various liens here involved (Pet. 12a–13a).

In Point V of its petition (pp. 11–12) the surety raises two separate issues. The first is whether the government "failed to file its notices of lien in accordance with the requirement of the statute [Section 6323(a)]", and the second is "[w]hether notice [of tax due under Sections 6303 and 6321] to a partnership is sufficient to bind the real property of each person who is a member of the partnership." However, on neither question does it demonstrate error below or allege a conflict with other appellate decisions. We submit that the well-reasoned and fully supported discussion of these questions in the opinion below (Pet. 5a–7a) shows that both were correctly decided.[5]

In sum, the decision below is correct, it is supported by the decisions of this Court, and is not in conflict with any other decision.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1962.

[5] *F. B. Baugh, Inc.* v. *Little Lake Lumber Co.* (C.A. 9), decided October 18, 1961 (61-2 U.S.T.C., par. 9726) (Pet. 12), deals with the effect on partnership property of a tax lien notice filed in the name of one partner; the case at bar involves the partners' individual properties and notices filed in a partnership name that is descriptive of all the partners

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 6303. NOTICE AND DEMAND FOR TAX.

(a) *General Rule.*—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

* * * * *

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

* * * * *

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof

has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

* * * * *

(b) *Form of Notice.*—If the notice filed pursuant to subsection (a)(1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

* * * * *

U.S. GOVERNMENT PRINTING OFFICE: 1966

TABLE OF CONTENTS

Page

ARGUMENT:

I. The question is whether enforcement of Section 6323(a), Internal Revenue Code, 1954, requires an application of the choateness rule to conventional mortgages 1

II. Money received by the surety (petitioner) from a separate source was not available for allocation by the Court to discharge Sundberg's earliest debts and thus advance the position of the federal tax lien to first in point of time 8

III. Uniform application of the revenue laws of the United States requires a direction from this Court concerning the filing of federal tax liens against partners and partnerships 10

IV. An application of the choateness rule to mortgages to secure future advances would have a destructive effect on existing business practices 11

INDEX OF CITATIONS

Brosnan v. United States, 363 U.S. 237, 241 11
F. B. Baugh, Inc. v Little Lake Lumber Co., (Cir. 9).. 10
Conrad v. Atlantic Insurance Co., 26 U.S. (1 Pet.) 386, 448 3
Elliott v. Sioux Oil Co. D. C. Wyom., 191 F. Supp. 847 6
Gauvey v. United States, 291 F.(2) 42, Cir. 8 (1961) .. 5
Henningsen v. United States F. & G. Co., 208 U.S. 404 8
Marteney v. United States, 10 Cir., 245 F.(2) 135 6
National Refining Co. v. United States, 8 Cir., 160 F(2) 951 5
Ormsbee v. United States, S.D. Fla., 23 F.(2) 926 .. 6
Prairie State Bank v. United States, 164 U.S. 227 ... 8
United States v. Ball Construction Co., 355 U.S. 587 1, 2, 3, 4, 13
United States v. Bond, 279 F.(2) 837 (Cir. 4) 4

Page

United States v. Boston & Berlin Transportation Co., D.C.N.H., 188 F. Supp. 304 5
United States v. Christensen, 269 F.(2) 624 (Cir. 9) .. 4
United States v. Gilbert Associates, Inc., 345 U.S. 361, 364 .....3, 11, 12
United States v. Halton Tractor Co., 9 Cir., 258 F.(2) 612 6
United States v. New Britain, 347 U.S. 80 ..... 1, 2
United States v. Ringler, D.C.N.D., Ohio, 166 F. Supp. 544 ..... 4, 5
United States v. Sampsell, 9 Cir., 1953 F.(2) 731 6

House Report No. 1018, 62d Cong., 2d Sess. (1912) .. 11

International Revenue Code of 1954:
Section 6321 2
Section 6323 .....2, 3, 5, 8, 13

Unpublished Ruling A-619373, issued August 24, 1956, Internal Revenue Service 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 575

AMERICAN SURETY COMPANY OF NEW YORK, a corporation, *Petitioner,*

v.

SUNDBERG & SONS, a partnership, et al., and the UNITED STATES OF AMERICA

REPLY AND SUPPLEMENTAL BRIEF ON BEHALF OF PETITIONER

ARGUMENT

I

The question is whether enforcement of Section 6323(a), Internal Revenue Code, 1954, requires an application of the choateness rule to conventional mortgages

Respondent would have the Court treat this case as simply another statutory lien case to be controlled by the choateness rule enunciated in *United States* v. *New Britain*, 347 U.S. 80, and subsequent decisions following that rule, including *United States* v. *Ball Construction Co.*, 355 U.S. 587. This approach is reflected in the sole question presented in respondent's

brief, which is pitched entirely on Section 6321, Internal Revenue Code, 1954, the Section that gave rise to the choateness rule.

Petitioner submits that more than the choateness rule is involved here because this case presents a conventional mortgage within the meaning of Section 6323, a different section of the statute. The question here is whether a conventional mortgage, such as this, is subject to the choateness rule, in the light of the provisions of Section 6323 of the statute.

The decision in *New Britain* does not answer this question because involved in that case was the relative priorities of statutory liens, not the priority of a mortgage. Indeed the *New Britain* decision itself shows the Court was considering only Sec. 6321, and not Sec. 6323, when it said (Pg. 88), "There is nothing in the language of Section 3672 [now 6323] to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interest set out therein, and the legislative history lends support to this impression." What this statement clearly means is that the Court was confining its attention to statutory liens comprehended by Section 6321, and was not considering the categories (such as mortgages) enumerated in Section 6323. It also seems to mean that if a conventional mortgage had been under consideration, the choateness rule would have no application.

Nor does the decision in *United States* v. *Ball Construction Co., supra,* furnish the answer, because in that decision there is no indication the Court felt it was dealing with a mortgage within the meaning of Section 6323. The decision merely states that,

> "The *instrument* involved being inchoate and unperfected, the provisions of Sec. 3672 (a), Revenue Act of 1939, 53 Stat. 449, as amended, 53 Stat. 882, 56 Stat. 957, do not apply." (Emphasis supplied)

Moreover, there are factual differences between this case and the *Ball* case. The lower Court found that presented here is a conventional mortgage according to the laws of the State of Washington. Previous decisions of this Court establish that the word mortgage as used in Section 6323 is to be construed in its usual and conventional sense. *United States* v. *Gilbert Associates, Inc.,* 345 U.S. 361, 364. Applying this rule, and citing Washington State authority, the Court below has held (Pet. 9a),

> "There can be no question but that under Washington law, if the mortgages were made to secure future advances, the trial Court was eminently justified in its determination that all advances under the mortgages related back, so far as the lien was concerned, to the date of the mortgage." [Citing 4 Pomeroy's Equity Jurisprudence (5th ed.) Sec. 1199, p. 596]

Likewise, Mr. Justice Story said in *Conard* v. *Atlantic Insurance Co.*, 26 U.S. (1 Pet.) 386, 448,

> "Mortgages may as well be given to secure future advances and contingent debts, as those which already exist, and are certain and due. The only question that properly arises is, the bona fides of the transaction."

No such established form of mortgage was present in *United States* v. *Ball Construction Co., supra.* On the contrary, involved there was an instrument (not further classified by this Court) not conventional in

character, which purported to assign to a surety the money yet to be earned by the contractor under a bonded contract, not only as security to the surety against any loss under the bonded contract, but also as security against loss by the surety resulting from any other contract between the parties. As it so happened, the loss involved in that case occurred under a contract other than the bonded contract mentioned. And so the *instrument* mentioned in *Ball* can hardly be regarded as a usual and conventional mortgage, as that term is used in Section 6323.

Respondent likewise relies on the decision in *United States* v. *Christensen,* 269 F. (2) 624 (Cir. 9); and *United States* v. *Bond,* 279 F. (2) 837 (Cir. 4), both of which involved the payment of some statutory state taxes by the mortgagee, after the filing of the federal tax lien, in order to protect the property against a forced tax sale; and the case of *United States* v. *Ringler,* D.C.N.D., Ohio, 166 F. Supp. 544. In the *Christensen* case there is some strong implication, not expressly mentioned, about the bona fides of the transaction, which, according to the decision, stemmed from a mortgage of $4,300, on some gambling property, to cover a note of $1,607. The Court held that the payment of taxes in the amount of $536.72 to protect the equity granted by this mortgage did not create a priority over an antecedent tax lien. In the *Bond* case the same sort of transaction was involved, although there seems no question about the *bona fides.* The *Bond* case involved payment of state taxes to protect the real estate, and also attorney's fees incurred in the litigation there present. The Court held that the federal tax lien antedated these payments and thus took priority, on the theory of first in time is

first in right. In the *Ringler* case, an attorney had taken an assignment to secure his fees for service thereafter to be rendered to a client in tax difficulties with the United States Government.

These are the cases chiefly relied upon by respondent. It is earnestly suggested that none of them arose from the kind of usual, conventional, established form of mortgage presented here. They all presented instruments or parts of instruments, of uncertain character, and outside the accepted type of mortgage document enumerated in Section 6323.

If the foregoing cases upon which respondent relies are to be accorded any weight, then they should be read along with decisions to the contrary, and of similar dignity, particularly the decision in *Gauvey* v. *United States,* 291 F. (2) 42, Cir. 8 (1961). This is a case in which a piece of equipment was sold under a conditional sales agreement, and also, the purchase price was secured by a chattel mortgage covering other equipment owned by the purchaser. The Court had no difficulty in holding that any of the categories enumerated in Section 6323 took priority over a subsequent tax lien, without regard to any choateness test. It quickly found that the chattel mortgage was one of the enumerated categories, and after some analysis it found that the conditional sales agreement, under the facts there presented, was likewise within one of the classes enumerated in Section 6323 (mortgage) and thus should not be subjected to any choateness test. Similar cases are *National Refining Co.* v. *United States,* 8 Cir., 160 F. (2) 951 (assignee of commissions to be earned held to be "purchaser"); *United States* v. *Boston & Berlin Transportation Co.,*

D.C.N.H., 188 F. Supp. 304 (buyer of trucking equipment held to be "purchaser", even though title was not to pass until after approval of sale by Interstate Commerce Commission); *Elliott* v. *Sioux Oil Co.*, D. C. Wyom., 191 F. Supp. 847 (assignment of income from oil leases to secure payment of debt held to be mortgage); and *Marteney* v. *United States*, 10 Cir., 245 F. (2) 135 (assignment of judgment while suit was still pending preferred over federal tax lien).

There are additional cases, some decided by the United States Court of Appeals for the Ninth Circuit, in all of which a mortgagee was preferred with respect to attorney's fees and similar expenses incurred after the tax lien was recorded, or with respect to state real estate taxes paid by the mortgagee after the recording of the federal tax lien: *United States* v. *Halton Tractor Co.*, 9 Cir., 258 F. (2) 612; *United States* v. *Sampsell*, 9 Cir., 153 F. (2) 731; and *Ormsbee* v. *United States*, S. D. Fla., 23 F. (2) 926.

If these numerous decisions serve no other purpose, they reflect a high degree of uncertainty on the part of lower courts concerning the rule to be followed in applying the terms of the pertinent sections of the Internal Revenue Code, 1954, to a mortgage, an uncertainty that would seem to dictate the grant of a writ of certiorari in this proceeding, so that a workable rule can be enunciated by this Court.

There is one additional point of importance which distinguishes this case from all cases cited in respondent's brief. In none of them does it appear that the advancement of the funds, when made, was a legal obligation, rather than the mere exercise of an option. In this proceeding the duty to make the

advances was obligatory, and was found to be under Washington law by the lower Court (Pet., 8a-9a).

> "The trial court concluded that they were mortgages to secure future advances and, relying on *Home Savings & Loan Ass'n* v. *Burton*, 1899, 20 Wash. 688, 56 P. 940; *Eltopia Finance Co.* v. *Colley*, 1923, 126 Wash. 554, 219 P. 24, and *Carey* v. *Herrick*, 1928, 146 Wash. 283, 263 P. 190, held that the priority related back to the date of the mortgage since the payments made were obligatory rather than optional. *Elmendorf-Anthony Co.* v. *Dunn*, 1941, 10 Wash. 2d 29, 116 P. 2d 253, 138 A.L.R. 558."

The mortgage presented here even meets the test laid down by the Internal Revenue Service itself in Unpublished Ruling A-619373, issued August 24, 1956, in that the advances made subsequent to recording of the federal tax lien were obligatory rather than optional.

It is well to bear in mind, in the light of the express provision in the mortgage, that the surety would be open to serious legal consequences if it had refused to consummate the advances it had promised to make; it would have not only been liable in damages to Sundberg, for breach of its mortgage agreement, but it would also have been liable to Boeing for failure to fulfill the condition of the performance bond, namely, to see the Sundberg contract completed according to its terms. In other words, the surety had no escape from the obligation to furnish the funds with which to complete the contract work, either by putting Sundberg in funds with which to do so, in accordance with the mortgage agreement, or by incurring the direct cost of performing the completion work itself, or through an entirely new contractor. Either way, the contractual obligation, when incurred,

was complete and valid between the parties immediately concerned, and since it antedated the filing of the federal tax liens, it was superior to those liens under the express wording of Section 6323, Internal Revenue Code, 1954. In this respect the document presented here differs from the instruments considered in the cases cited by respondent.

II

Money received by the surety (petitioner) from a separate source was not available for allocation by the Court to discharge Sundberg's earliest debts, and thus advance the position of the federal tax lien to first in point of time

Petitioner has made the argument, that the lower Court was in error when it sought to advance the priority position of the federal tax lien, by allocating certain monies received by the surety from Boeing, in such a way as to dissolve the initial advances made by the surety under the mortgage. With all due respect to respondent, petitioner has been unable to understand respondent's purported answer to this proposition (Reply, 8),

> "* * * it was manifestly necessary to apply those receipts against the surety's expenditures to determine the amount that the surety was out-of-pocket on the contract, i.e., the amount for which the Sundbergs are liable (and for which their properties stand as security)."

While the foregoing may be true, it is submitted it constitutes no answer to Point IV of the petition. (Pet. 9) Petitioner makes the point, and respondent admits (Reply, 8), that both as an express assignee, and by operation of law (*Henningsen* v. *United States F. & G. Co.*, 208 U.S. 404; *Prairie State Bank* v. *United States*, 164 U.S. 227), the surety was entitled to all sums that accrued under the Boeing contract.

This was money that it owned, money that neither Sundberg as principal on the bond, nor the United States as either an antecedent or subsequent tax lienor, could successfully claim according to an overwhelming preponderance of authority. This was not Sundberg money available for allocation to Sundberg's total indebtedness to the surety.

As of October 26, 1955, the filing date of the first federal tax lien, the surety had advanced to Sundberg an admitted total of $35,721.33. (Pl. Ex. No. 11—Rec. Pg. 76). This was all prior to the first recording of the tax lien. The lower Court, and respondent here, assert that in judging the relative priorities of the mortgage versus the tax lien, all of these initial advances must be disregarded, because during the same period that these initial advances were made the surety received from Boeing a total sum of $26,217.73 (Pl. Ex. No. 11—Rec. Pg. 76), and during the period following the first recording of the tax lien the surety received additional sums, more than enough to equal the figure of $35,721.33 mentioned above. (It will be noted that the receipts prior to the first filing of the tax lien, October 26, 1955, fell short of the total advances by $9,503.60.)

By reason of the foregoing receipts from Boeing, and in order to set up the tax lien of October 26, 1955, as first in time, the lower Court would allocate all of the receipts by the surety from Boeing as if they were Sundberg money, instead of surety money, and as authority for doing so, the lower Court cites in a footnote (Pet. 3a) certain Washington cases. The cases cited are undoubtedly the law of the State of Washington, as well as most other states, and they stand for the maxim—"First in, first out." This

maxim means that where a debtor makes a lump sum payment to a creditor, without specific allocation to any of numerous outstanding debts (advances), the Court will apply the payment beginning with the advance or debt that was "first in", meaning first incurred. But this maxim applies only where the court is dealing with a debtor-creditor relationship, and where payments by the debtor with the debtor's own funds are involved. It is never applied where the creditor has received money from a separate source, to which it already had legal and equitable title.

The lower Court erred, and respondent is in error, when it admits that the Boeing money was the property of the surety, not Sundberg, and at the same time attempts to apply the "first in, first out" theory in such a way as to dissolve the initial surety advances to Sundberg, and thus set up the initial recording date of the tax lien as first in point of time. Without this erroneous allocation, the tax lien was not first in time, and thus there is no basis for application of the choateness rule.

III

Uniform application of the revenue laws of the United States requires a direction from this Court concerning the filing of federal tax liens against partners and partnerships

Petitioner has made the point that the tax liens involved here named only the partnership whereas the property involved was held by the partners as individuals, and the petition cites *F. B. Baugh, Inc.* v. *Little Lake Lumber Co.* (Cir. 9), as holding that this filing does not conform to the requirements of Sections 6303 and 6321 of the Internal Revenue Code, 1954. The lower Court has held to the contrary.

Thus there is a conflict between the United States Court of Appeals for the Ninth Circuit, and the Supreme Court of the State of Washington. There has been no previous ruling by this Court on this subject. A uniform application of the revenue laws of the United States would seem to dictate a granting of the writ of certiorari so that the point can be finally settled. *United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 364.

IV

An application of the choateness rule to mortgages to secure future advances would have a destructive effect on existing business practices

The legislative history of Section 6323 (a), taken together with the decision of this Court in *Brosnan* v. *United States*, 363 U.S. 237, 241, clearly establishes that in considering the relative position of federal tax liens in the business fabric of the country something more than first in time is first in right needs to be considered. In *House Report No. 1018, 62d Cong., 2d Sess. (1912)*, relating to a proposed amendment of Section 6323 (a), it was said,

> "The recent act relating to excise tax by corporations makes it imperative that some legislation of this kind be enacted in order to protect the transfer of property, and to facilitate business transactions. There is no reason why the Government should not occupy the same position with reference to liens on property as does the individual."

In *Brosnan* v. *United States, supra*, this Court was considering a sale of property under a *fieri facias* which had the effect of extinguishing a junior federal tax lien, and said,

> "* * * We think it more harmonious with the tenets of our federal system and more consistent with what Congress has already done in this area not to inject ourselves into the network of competing private property interests, by displacing well-established state procedures governing their enforcement or superimposing on them a new federal rule. Cf. *Board of Comm'rs* v. *United States,* 308 U.S. 343."

To apply the rule of choateness to the facts of this case would unquestionably disrupt, if not destroy, many conventional practices, established for a long period of time in the financial, and particularly the construction industry. It would inject a new rule of taxation into an existing network of competing private property interests. On construction projects, particularly those related to housing, mortgages to secure future advances to be made as the work progresses, have become a fixture. The same is true to a lesser extent in the heavy construction industry. Another important application of the technique finds its place in agriculture, where mortgages are frequently used to secure future advances to be made as crops develop. There are other applications too numerous to mention.

If the choateness rule is to be uniformly applied to this type of mortgage, on the strength of previously decided cases, then a writ of certiorari is here required so that such a rule can be unequivocally announced by this Court for the benefit of all concerned. As was said in *United States* v. *Gilbert Associates, Inc.,* 345 U.S. 361, 364: "A cardinal principle of Congress in its tax scheme is uniformity, as far as may be. Therefore, a 'judgment creditor' [as used in 26 U.S.C. (1946 ed.), Sec. 3672] should have the same application in all the states."

Under the present condition of the law, as it exists since the *per curiam* decision in *United States* v. *Ball Construction Co., supra,* great confusion prevails in the lower courts, and in the legal profession, regarding the relationship between the choateness rule and the provision of Section 6323 (a), Internal Revenue Code, 1954. This fog can be dispersed by a consideration by this Court of this case at this time.

Respectfully submitted,

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February 9, 1962